

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING 04-13**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee sales and use tax to sales and leases of medical equipment and supplies to individuals that are billed through TennCare.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;

- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is a corporation that sells and leases medical equipment and supplies in Tennessee. The Taxpayer's sales in Tennessee may be divided into three general categories: (i) sales and leases billed to and paid for by the individual patient or the patient's health insurance provider, (ii) sales and leases made to an individual patient and reimbursed through the federal Medicaid program, and (iii) sales and leases to individual patients which are covered under the TennCare program.

QUESTIONS

1. Whether sales and leases of medical equipment and supplies to individuals are exempt from sales and use tax billed through the TennCare program.
2. Whether the 2002 change separating TennCare into three programs, one of which is TennCare Medicaid, results in exemption for the equipment and supplies provided under the new TennCare Medicaid designation.

RULINGS

1. No.
2. No.

ANALYSIS

(1-2) In *Cape Fear Paging Co. v. Huddleston*, 937 S.W.2d 787 (Tenn. 1996), the Tennessee Supreme Court observed that "pursuant to the Retailer's Sales Tax Act, TENN. CODE ANN. §§ 67-6-101 - 67-6-712, a tax is imposed upon the business of selling tangible personal property at retail unless specifically exempted by statute." Unless an exemption statute can be found, the sale or use of tangible personal property is subject to tax. In construing an exemption from

the sales and use tax, the statute is strictly construed against the taxpayer with a presumption against the exemption. An exemption from taxation will not be read into a taxing statute by implication. *Pan Am World Services, Inc. v. Jackson*, 754 S.W.2d 53 (Tenn. 1988).

Tennessee law provides for several statutory exemptions to the sale of medical items.¹

In addition, TENN. CODE ANN. § 67-6-329(a)(13) exempts sales to the State of Tennessee from Tennessee sales and use tax as follows:

(a) The sale at retail, the use, the consumption, the distribution and the storage for use or consumption in this state of the following tangible personal property is specifically exempted from the tax imposed by this chapter:

(13) All sales made to the state of Tennessee or any county or municipality within the state;

TENN. COMP. R. & REGS. 1320-5-1-.55, quoted below, further clarifies sales and use tax exemptions to State of Tennessee entities. According to the Rule, all sales to the State of Tennessee or its political subdivisions are exempt from sales and use tax provided the governmental body actually makes the purchase and obtains title to the property and directly pays the dealer for it. The Rule also states that sales to contractors for the use or benefit of the governmental body are subject to sales and use tax.

(1) Sales of tangible personal property ... to the State, or a county, or municipality within the State of Tennessee are not subject to the sales or use tax provided that such governmental institution furnishes the vendor with a properly executed exemption certificate; however, any sale made to a State other than Tennessee, or a county or municipality not located within Tennessee, is subject to the sales tax.

(2) In order to be a sale to the State of Tennessee, or a county or municipality in this State, the State, county, or municipality must make the purchase of the property ..., obtain title to the property ... immediately when it is delivered, and pay directly to the dealer supplying the property ... the purchase price of such

¹ See, e.g., TENN. CODE ANN. §§ 67-6-304 (Blood and plasma); 67-6-312 (Insulin); 67-6-314 (Medical Equipment and devices for handicapped persons); 67-6-316 (Optometrists, opticians, and ophthalmologists); 67-6-317 (Ostomy products); 67-6-318 (Oxygen); 67-6-319 (Pharmaceutical samples-Free drugs and materials); 67-6-320 (Prescription drugs); and 67-6-352 (Pharmacies and home health care providers).

property ...

(3) Sales of tangible personal property and taxable services to a contractor or other person for the use and later benefit of the State or a county, or municipality in this State, are subject to the appropriate sales and use tax.

(4) Dealers must have an appropriate governmental exemption certificate for any tangible personal property or taxable service which is sold to governmental institutions from whom the sales and use tax is not collected, and keep such certificate as a part of their records to show that such sales are exempt from the sales and use tax.

Effective January 1, 1994, the State of Tennessee was granted a waiver by the Secretary of Health and Human Services and the Health Care Financing Administration to withdraw from the Medicaid program and establish a public health system known as TennCare. TennCare replaced the Medicaid program with a new program of managed care and expanded health care coverage to include uninsured or uninsurable individuals as well as Medicaid eligible individuals. TennCare is financed by pooling current federal, state and local expenditures for indigent health care including the money that the federal government would have provided Tennessee had it remained in the Medicaid program.

On July 1, 2002, Tennessee reached a new five-year agreement with the federal government to continue TennCare. The agreement separated TennCare into three programs: TennCare Medicaid, TennCare Standard and TennCare Assist. TennCare Medicaid is a continuation of the federal Medicaid program with a few minor changes in benefits, and a three-tiered pharmacy co-payment structure that began January 1, 2003. TennCare Standard was projected to function much like a commercial HMO package. However, these changes never occurred. As a result, TennCare Standard provides the same benefits as TennCare Medicaid. TennCare Assist was scheduled to be created and detailed during the legislative session that began in January 2003. However, this program was contingent on funding and was never begun.

Under the TennCare program, the State of Tennessee does not directly pay for health care services delivered to enrollees. TennCare services, as determined medically necessary, cover inpatient and outpatient hospital care, physician services, prescription drugs, lab and x-ray services, medical supplies, home health care, hospice care, and ambulance transportation. TennCare services are offered through managed care organizations ("MCOs") and behavioral health organizations ("BHOs"). Under this system, the individual medical providers bill the MCOs and BHOs for the medical services provided to TennCare enrollees.

The MCOs and BHOs pay the individual providers once reimbursement from TennCare is received.²

Under the facts presented, no sales or use tax is being levied against the State of Tennessee. The sales are made, not to the State of Tennessee, but directly to MCOs, BHOs or their providers. The State of Tennessee contracts with MCOs and BHOs to provide medical services and medical supplies to TennCare enrollees. The Tennessee sales and use tax exemptions for direct sales to the State of Tennessee found in TENN. CODE ANN. § 67-6-329(a)(13) and Departmental Rule 1320-5-1-.55, do not apply because no direct sales to the State of Tennessee are involved.

Sales or leases made to an individual and reimbursed through the TennCare program are taxable to the extent that the items sold are subject to tax, because the sale is to the individual. An assignment of the payment of TennCare benefits to the vendor (taxpayer) does not change the nature of the sale. Even if the medical supplies could be said to be for the use and benefit of the state under the TennCare program, Departmental Rule 1320-5-1-.55(3) specifically provides that sales of tangible personal property to a contractor for the use and later benefit of the State of Tennessee are subject to the tax.

Costin D. Shamble
Tax Counsel

APPROVED: Loren L. Chumley
Commissioner

DATE: 04/28/04

² Prior to the 2002 change in the TennCare program, the managed care programs negotiated payment rates with individual providers and received a per member, per month fee (capitation) for each TennCare enrollee, based on various criteria, such as age, gender, geographic location, eligibility, etc.